



STATE BOARD OF EQUALIZATION
PROPERTY TAXES DEPARTMENT
450 N STREET, MIC: 63, SACRAMENTO, CALIFORNIA
(PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0063)
TELEPHONE (916) 445-1516
FAX (916) 323-8765

JOHAN KLEHS
First District, Hayward

DEAN F. ANDAL
Second District, Stockton

CLAUDE PARRISH
Third District, Torrance

JOHN CHIANG
Fourth District, Los Angeles

KATHLEEN CONNELL
Controller, Sacramento

E. L. SORENSEN, JR.
Executive Director

June 8, 1999

No. 99/35

TO COUNTY ASSESSORS AND INTERESTED PARTIES:

REVISION OF PROPERTY TAX RULE 133

We advised interested parties on May 7, 1999 that Board staff would undertake a revision of Property Tax Rule 133, Business Inventory Exemption. At that time we also provided interested parties with staff's proposed revisions to the rule and requested suggestions and comments regarding this draft. Enclosed is a matrix summarizing the suggestions and comments received by staff. The position of Board staff regarding each proposed change is also noted.

We have scheduled an interested parties meeting at 9:00 a.m. on June 22, 1999, at the Board's headquarters in Sacramento, 450 N Street, Room 122, to discuss the issues and the specific suggestions listed in the enclosed matrix. The meeting will begin with discussion on revisions to Rule 133, followed by discussion of revisions to Rule 10, Trade Level for Tangible Personal Property. The matrix for Rule 10 was mailed separately on June 3.

If you have any questions regarding the revision of this rule, the enclosed matrix, or the interested parties meeting, please contact Gordon Ferguson at (916) 322-3815 or Ladeena Ford at (916) 324-5839.

Sincerely,

/s/ Richard C. Johnson
Richard C. Johnson
Deputy Director
Property Taxes Department

RCJ:gf
Enclosures

PROPERTY TAX RULE 133
PROPOSED CHANGES TO STAFF MAY 7, 1999 VERSION (Attachment B "Clean Version")
(Page and Line numbers refer to Attachment B, mailed May 7, 1999)

No.	Page No.	Line No.	Source	Proposed Amendment	SBE Staff Position
1.	1 1	26 32	Fresno Co.	<p>(2) "Business inventories" includes:</p> <p>(B) New and used oak barrels used in the manufacturing process, that physically incorporate the flavor- and aroma-enhancing chemical compounds of the oak into wine or brandy to be sold, when used for this purpose. <u>are business inventory in part. Since only minute portions of the barrels are incorporated into the finished goods the barrels are only partially exempt. The use of the barrel as storage is not a use, which qualifies as business inventory. However</u> Likewise, an oak barrel is no longer business inventory once it loses the ability to impart the chemical compounds that enhance the flavor and aroma of the wine or brandy. An "oak barrel" used in the manufacturing process is defined as having a capacity of 200 gallons or less. Oak barrels not used in the manufacturing process but held for sale in the ordinary course of business are also considered business inventory. <u>The amount of exemption shall be based on the economic data relevant to the proportional contribution made by the barrels to the manufacturing process.</u></p>	<p>Disagree. The intent of the rule is not to allocate among exempt and nonexempt values of a particular property based on multiple uses but rather to determine eligibility based on the primary use as inventory. In the existing rule, the "primary use " of property as inventory qualifies the entire property for the inventory exemption. There is no requirement that the property be exclusively used as inventory in order for the entire property to receive a total exemption. Thus, there is no provision for a partial exemption based on uses other than the primary use as inventory.</p> <p>As described in the rule, the primary use of oak barrels eligible for the exemption is their use as an essential ingredient in the wine- or brandymaking process, i.e. the transfer of chemical compounds into the wine or brandy. Therefore, we conclude that when oak barrels are used for this purpose they are entirely exempt as business inventory.</p>
2.	1	37	American Brandy Assoc.	An "oak barrel" used in the manufacturing process is defined as having a capacity of 200 <u>212</u> gallons or less.	Agree. 212 gallons is equivalent to an 80-liter barrel, which is the largest size barrel used for aging brandy.

MATRIX DRAFT OF RULE 133

Rule 133. BUSINESS INVENTORY EXEMPTION.

Reference: Sections 129, 219, Revenue and Taxation Code.

(a) SCOPE OF EXEMPTION.

(1) "Business inventories" that are eligible for exemption from taxation under section 129 of the Revenue and Taxation Code include all tangible personal property, whether raw materials, work in process or finished goods, which will become a part of or are themselves items of personalty held for sale or lease in the ordinary course of business.

(A) The phrase "ordinary course of business" does not constitute a limitation on the type of property which may be held for sale or lease, but it does require that the property be intended for sale or lease in accordance with the regular and usual practice and method of the business of the vendor or lessor.

(B) The phrase "goods intended for sale or lease" means property acquired, manufactured, produced, processed, raised or grown which is already the subject of a contract of sale or which is held and openly offered for sale or lease or will be so held and offered for sale or lease at the time it becomes a marketable product. Property which is ready for sale or lease must be displayed, advertised or otherwise brought to the attention of the potential purchasers or lessees by means normally employed by vendors or lessors of the product.

(2) "Business inventories" includes:

(A) Containers or container material such as kegs, bottles, cases, twine and wrapping paper, whether returnable or not, if title thereto will pass to the purchaser or lessee of the product to be sold or leased therein.

(B) New and used oak barrels used in the manufacturing process, that physically incorporate the flavor- and aroma-enhancing chemical compounds of the oak into wine or brandy to be sold, when used for this purpose. However, an oak barrel is no longer business inventory once it loses the ability to impart the chemical compounds that enhance the flavor and aroma of the wine or brandy. An "oak barrel" used in the manufacturing process is defined as having a capacity of 212 gallons or less. Oak barrels not used in the manufacturing process but held for sale in the ordinary course of business are also considered business inventory.

(C) Materials such as lumber, cement, nails, steel beams, columns, girders, etc., held by a licensed contractor for incorporation into real property, providing the real property will not be retained for the licensed contractor's use.

MATRIX DRAFT OF RULE 133

(D) Crops and animals held primarily for sale or lease and animals used in the production of food or fiber and feed for animals in either category.

(b) EXCLUSIONS. Property eligible for the "business inventories" exemption does not include:

(1) Property of any description in the hands of a vendee, lessee or other recipient on the lien date which has been purchased, leased, rented, or borrowed primarily for use by the vendee, lessee or other recipient of the property rather than for sale or lease or for physical incorporation into a product which is to be sold or leased. Examples of property excluded from business inventories are office supplies, furniture, machines and equipment and manufacturing machinery, equipment and supplies such as dies, patterns, jigs, tooling or chemicals used to produce a chemical or physical reaction, and contractors' supplies, tools, concrete forms, and other items that will not be incorporated into and become a part of the property. Also ineligible are materials that a contractor is holding to incorporate into real property that will be retained for his own use.

(2) Property being used by its owner for any purpose not directly associated with the prospective sale or lease of that property.

(3) Property actually leased or rented on the lien date.

(4) Property which has been used by the holder prior to the lien date, even though held for lease on the lien date.

(5) Property intended to be used by the lessor after being leased or during intervals between leases even though held for lease on the lien date.

(6) Property in the hands of a lessor who, with intent to enjoy the benefits of the inventory exemption, had leased the property for a period that expired shortly before the lien date but who renewed, extended or renegotiated the lease shortly thereafter.

(c) SERVICE ENTERPRISES. Property held by a person in connection with a profession which is primarily a service activity such as medicine, law, architecture or accountancy is not "business inventories" held for sale or lease even though such property may be transferred to a patient or client incidental to the rendition of the professional service. Property held by enterprises rendering services of a nonprofessional type such as dry cleaners, beauty shop operators and swimming pool service companies is to be regarded as "business inventories" held for sale if such property is delivered to the customer as an item regularly included in the service.

(d) REPAIRERS AND RECONDITIONERS. Persons engaged in repairing or reconditioning tangible personal property with the intent of transferring parts and

MATRIX DRAFT OF RULE 133

materials shall be regarded as holding said parts and materials as "business inventories."

(e) AGRICULTURAL ENTERPRISES. Animals, crops and feed held primarily for sale or lease in the ordinary course of business are included in the term "business inventories," as are animals used in the production of food or fiber and feed for such animals.

(1) "Animals used in the production of food and fiber" includes all animals customarily employed in the raising of crops or for the feeding, breeding and management of livestock, or for dairying, or any other confined animals whose products are normally used as food for human consumption or for the production of fiber useful to man. Excluded are animals held by an owner or lessee principally for sport, recreation or pleasure such as show animals, horses kept for racing or horses and other animals kept as pets.

(2) The term "crops" means all products grown, harvested, and held primarily for sale, including seeds held for sale or seeds to be used in the production of a crop which is to be held primarily for sale. It does not include growing crops exempted pursuant to Article XIII, Section 3 (h), of the California Constitution or fruit trees, nut trees, and grapevines exempted by Section 223 of the Revenue and Taxation Code.

(3) The term "food" means property normally considered as food for human consumption.

(4) Feed for animals held primarily for sale or lease or for animals used in the production of food or fiber constitutes "business inventories" subject to exemption. It includes every type of natural-grown or commercial product fed to animals except medicinal commodities intended to prevent or cure disease unless the medicinal commodities are purchased as a component part of feed for such animals.

History: Adopted November 20, 1968, effective December 21, 1968.
Amended January 7, 1970, effective February 8, 1970.
Amended January 6, 1971, effective February 18, 1971.
Amended February 5, 1975, effective March 20, 1975.
Amended August 20, 1980, effective November 14, 1980.
Amended October 10, 1984, effective February 21, 1985.